439 tons British. The Niemen is navigable as far as the Lithuanian-
505 Polish 'administrative line', and is used for cargo traffic as far as
361 Kaunas.

361 The administration of the harbour is provided for in an annex to
504 the Memel Statute of 1924, and is controlled by a board consisting
475 of one member appointed by the Lithuanian Government, one by the Memel Directorate, and one by the League of Nations. Since 1924 noteworthy steps have been taken to improve the technical equipment of the port. The harbour has been extended and deepened, docks have been excavated, cranes have been installed, and ware-
[457] houses built, the cost, running into 'several tens of millions of lits',[1] being borne mainly by the Lithuanian Government. Some of the expenditure, however, has been met out of a loan issued by the city in 1927 amounting to 4,000,000 RM. nominal and offered in Germany.

361 As has already been mentioned, Memel is a comparatively impor-
438 tant industrial centre. Of the 1,056 industrial enterprises in Lithuania employing 5 or more workmen at the beginning of 1937, 137 were in Memel, and of the 30,561 persons employed in such industries throughout Lithuania, 8,112 were employed in the Memel Territory. The more important industries include sawmills, veneer works, chemical fertilizer plants, and cellulose undertakings. There are also textile and tobacco factories of some size.

361 Outside the industrial district of the Territory the principal
241 occupation is agriculture. It is impossible to give any indication as
439 to the volume of production, since the figures are included with those of Lithuania proper. According to the available information, however, there is normally a small surplus of production for export; and since the easiest, if not the only, market is East Prussia, the agricultural population of the Territory suffered considerably from the virtual suspension of commercial intercourse between Lithuania and Germany owing to the dispute of 1932–5. The Agreement of August 1936 was consequently followed by an appreciable improvement.

361 The Statute of 1924 gives the Administration powers to levy direct
[651] and indirect taxation inside the Territory with the exception of
[652] Customs and excise duties and certain monopolies. The Territory has a separate budget, which in 1934 balanced at about 14 million lits. The only funded debt outstanding is the loan of 1927 already mentioned. Owing to the harbour's international importance, there is a comparatively large number of commercial and other banks domiciled in the Territory.

[1] *Lithuanian Telegraph Agency (Elta) Service*, March 1936.

1 [see above, line 12 -- Analyst]

mentioned, there had grown up an important series of manufacturing industries before the War. Some depended on local raw materials such as timber, but, in general, the pre-War industry of these territories took the form of the conversion of imported raw materials into finished articles, which were sold in Russia. The extent of these industries may be judged from the fact that in 1910 more persons were employed in the textile, chemical, and metal industries of Latvia than the entire number of those employed in all the industries of the country in 1926. Moreover, Reval (Tallinn) was one of the most important shipbuilding bases of the Russian Empire, while at Krainholm there existed one of the largest cotton mills in the world.[1]

The War, and the establishment of independent States, changed the whole position. The Russian market, the basis of the manufacturing industry, was lost. The indispensable raw materials could no longer be imported on the pre-War scale; and, as has been seen, the mineral resources of Estonia (except for oil-shale) and Latvia are negligible from the commercial point of view. Moreover, the War had brought devastation which in many cases it would have been impossibly expensive to repair even if markets had existed; in Latvia, which was perhaps most severely affected, the retreating Russians had carried off most of the machinery which could be moved, and many of the factories were no more than empty buildings. Finally, the demands of economic nationalism required that Lithuania should make some attempt to develop manufacturing industries of her own where none had existed before.

It is impossible to trace here the steps by which some kind of order was produced from the chaos of the years immediately after the War. In general, the policy of Estonia and Latvia was to develop only those industries which were essential to local requirements, or which could exist without the Russian market. Within this limited scope, a considerable measure of success was achieved during the period. The State was occasionally able to make good the loss or destruction of machinery through foreign relief credits received immediately after the War, and when some degree of economic and political stability had been achieved in the Baltic, foreign capital—chiefly German and British—was made available to industry through the banking system. It was even possible to obtain a small footing in the export market, for the standard of living in Estonia and Latvia was comparatively low, and costs were often on a good competitive

[1] The early development of the cotton industry in Estonia was largely due to a British-trained German, Julius Knoop (1811–94), who eventually came to dominate the entire textile industry of Russia. For further details, see L. H. Jenks, *The Migration of British Capital*, New York, 1927, pp. 183–4. A fuller account will be found in *Krainholm Manufaktur 1857–1932*, privately printed by the Gesellschaft der Krainholm Manufaktur für Baumwollfabrikate, 1933.

439 at co-operation was that, among the three Baltic States, the practice grew up of including in commercial treaties concluded with non-Baltic countries the so-called 'Baltic clause'. By this clause the Baltic States reserved for application as between themselves certain privileges which could not be passed on to other countries by virtue of the most-favoured-nation clause.[1] However, the practical results of this measure do not appear to have been substantial.

Other Countries. Apart from the United Kingdom and Germany, the principal markets, then, consisted of the Scandinavian countries and Belgium; Lithuania's commercial intercourse with Poland came to an almost complete standstill after the Vilna incident. Exports to the rest of Europe were negligible, in spite of the conclusion of numerous bilateral agreements during the period. Imports from the rest of Europe also were small except for Czechoslovak textiles and machinery from Belgium. However, the proportion of imports from the U.S.A. was fairly considerable during the period. These consisted largely of agricultural and other machinery.

4. Balance of Payments, 1919–30

439 During this period there was a fundamental difference between the
● 457 position in Latvia and that in the other two countries, since Latvia's merchandise imports invariably exceeded her exports by a large margin:

Table 25. *Value of Exports expressed as a Percentage of that of Imports*

	Estonia	*Latvia*	*Lithuania*
1923	61·2	76·5	93·7
1924	95·9	66·6	129·2
1925	100·1	63·8	96·9
1926	100·7	72·4	106·5
1927	109·8	88·5	92·6
1928	96·6	84·0	88·2
1929	95·9	75·7	107·7
1930	98·1	83·8	106·9

Throughout the period the foreign trade balance was, as might be expected, of decisive importance to the balance of payments, the position of which tended to fluctuate with the price of timber and butter. The period can hardly be called normal, for after the War there was naturally a quite abnormal increase of imports for reconstruction purposes, which was financed largely by foreign capital in one form or another, e.g. the League Loan to Estonia, and the loans obtained by all three countries from the Swedish Match group.

[1] The Baltic clause is examined from a legal standpoint by Dr. Nikolas Kaasik in *Baltic Countries*, vol. i, no. 2, December 1935.

1: Anonymous U-4 (no date)1938 RBl Baltic States RB1

Medium-term credit also was provided to some small extent by 457 foreign bankers for such purposes. Unfortunately the estimates of the balance of payments for this period are incomplete and contain numerous discrepancies.[1] It is therefore impossible to compile comparative figures as to capital movements which would not be misleading. However, some indication as to the structure of the current account can be obtained from the following table, giving details of the last three years before the depression:

TABLE 26. *Balance of Payments, 1927–9 (current items only)*

(In million Swiss francs)

	Estonia			*Latvia*			*Lithuania*		
	1927	*1928*	*1929*	*1927*	*1928*	*1929*	*1927*	*1928*	*1929*
I. *Merchandise*									
Merchandise	+13·1	−6·1	−7·5	−32·6	−46·8	−33·1	−13·3	−20·2	+9·1
Adjustments:									
(a) Ships purchased abroad	− 1·0	−1·4	− 1·8	− 2·9	− 4·2	− 5·2	..	..	..
(b) Other adjustments	..	..	..	+30·5*	+36·0*	+43·3*	− 1·4	− 1·6	− 2·1
II. *Interest and Dividends***									
Interest on intergovernmental debt	− 3·6†	−5·1†	− 2·6	‡	‡	‡	− 0·3	− 0·5	− 1·1
Interest on other public debt	..	..	− 2·8	..	..	− 1·9	− 0·3	− 0·5	− 1·0
Interest on other long- and short-term debt	− 5·6§	−5·6§	− 2·8	− 7·5	− 3·3	− 4·0§	+ 0·1	− 0·2	− 0·6
III. *Other Items***									
Shipping freights	+ 5·6	+5·8	+11·1	+ 4·8	+ 8·7	+10·0	..	..	..
Port fees, &c.	− 1·5	−1·5	− 5·7	+ 1·1	+ 1·1	+ 1·0	+ 0·2	+ 0·1	+ 0·2
Transit fees, warehousing &c.	+ 0·8	+1·0	+ 0·4	+ 8·7	+11·7	+13·1	+ 3·1	+ 3·4	+ 3·8
Insurance	..	−0·1	− 0·8	..	+ 0·3	− 0·2	+ 0·2	− 0·7	+ 1·5
Banking commissions, &c.	..	..	..	+ 0·2	+ 0·3	..	+ 0·1	+ 0·2	+ 0·1
Posts, telegraphs, and telephones	+ 1·2¶	+1·7¶	+ 0·8	+ 0·2	− 0·1	..	+ 0·6	+ 0·6	+ 0·7
Immigrant and emigrant remittances	− 1·8	−0·6	− 1·4	+ 8·0	+ 8·0	+ 8·0	+15·1	+17·8	+14·8
Tourist expenditure	+ 1·8	+2·6	+ 0·1	+ 7·2	− 6·7	− 1·6	− 2·1	− 1·1	− 0·2
Diplomatic expenses	+ 0·6	+0·5	+ 0·7	+ 3·2	+ 3·2	+ 3·2	− 0·2	− 0·1	− 0·2
Other Government receipts and expenses	− 0·7	−0·7	− 0·7	+ 1·3	+ 1·2	+ 0·2	+ 0·6	+ 0·6	+ 0·6
Other current items	− 0·6	−0·4	− 0·3	..	− 1·4	− 2·7	+ 2·0	+ 1·0	+ 0·6
IV. *Bullion*	..	+0·1	+ 0·1	− 0·2	− 0·6	− 0·1	..	− 0·1	− 0·1
Balance	+ 8·6	−2·8	−13·7	+23·0	+ 7·4	−25·3	+ 5·3	− 1·6	+25·4

[*Note*: The figures for individual items are probably not strictly comparable as between the three countries, but they do afford a rough basis for comparison.]

* Adjustment for wrong valuation. † Including payments in respect of League Loan. ‡ These items were included in the capital account. The total debits for interest and amortisation were in each year less than 2½ million Swiss francs. § Long-term debt only. ‖ Including banking commissions. ¶ Including some emigrants' remittances. **Net.

It will be seen that the main credit items were those which arose out of port dues, shipping, and the transit trade, mainly to and from the U.S.S.R.; in Latvia the income from the transit trade was one

[1] e.g. those for Estonia; cf. League of Nations memorandum on *Balances of Payments, 1926–9*, p. 76.

467 of the most important invisible exports during the period, while emigrants' remittances were of considerable importance in Lithuania and to a lesser extent in Latvia. These remittances were mostly from the large number (particularly Lithuanians) of emigrants to the U.S.A.; the figures tend to vary with conditions in that country. It may be observed that these remittances were sometimes sent for investment, and the inclusion of the total figure as a current item is therefore questionable. The only other credit item calling for comment is the adjustment of the Latvian merchandise balance. This consisted largely of a deduction of 10 per cent. from the value of imports, which was officially explained on the ground that a large proportion of Latvia's imports were sent to Riga on consignment and purchased at prices appreciably below those given in the invoices.

The only debit item of any importance consisted of interest and dividends. During this period, at any rate, the service of the foreign debt, private and public, did not occupy a disproportionate position in, or put any great strain on, the balance of payments; and in this respect there is no indication that these countries were suffering from over-indebtedness. It may thus be said that by 1929 these countries had adjusted their balance of payments to the conditions then obtaining. The large excess of merchandise imports which had become natural to Latvia was, however, to call for a radical readjustment in the following period; and the fact that in many ways the financial crisis was more severe in Latvia than in the two other countries may largely be ascribed to this consideration.

III. THE FINANCIAL SYSTEM, 1919–30

1. Currency and Monetary Policy

436 At the end of the War the new States of the Baltic were left to develop monetary systems of their own. Having no substantial financial resources they were almost entirely at the mercy of the large States, such as the U.S.S.R. and Germany, who were their neighbours, for the currency in circulation when the Baltic States achieved their independence was to a very great extent that of Germany and Russia. In all three countries Ostmarks and Reichsmarks were to be found side by side with different varieties of roubles such as Tsarist, Kerensky, Duma, and Ost roubles; in Estonia it is said that commercial transactions even took place on the basis of Finnish marks and Danish or Swedish crowns. The currency in circulation thus fluctuated with that of the issuing State, and a period of great confusion followed.

It is not proposed that a detailed examination should here be made of the various stages by which, in each of these three States,

436 working capital through the *Eesti Pank*. Meanwhile, though the
652 bank was able to keep the mark more or less stable at the rate to
648 which it had depreciated by 1921, this was effected only at the cost of a large proportion of its reserves. This led to a severe crisis in the autumn of 1924 and the League of Nations was called in to advise.[1]

The restriction of credit which followed on this step enabled Estonia to maintain the stability of the currency at the depreciated rate. For the *de jure* stage of stabilization, appeal was again made to the League in November 1926. Their report[2] recommended the reform of the *Eesti Pank*, and the transfer of the long-term assets it had accumulated through the Government's earlier industrial policy to a specially created Mortgage Institute, both of which recommendations had been made in the earlier report but had not yet been put
648 into effect. The League also advised the introduction of a new
● 457 currency. To enable these reforms to be realized an international loan was required, and, if the necessary changes were made, the League declared its readiness to allow the loan to be issued under its auspices.

457 The loan was issued in June 1927, £700,000 in London and
652 Amsterdam at 94½, and $4,000,000 in New York at the same price. £1,000,000 of the proceeds went to purchase the long-term assets of the *Eesti Pank*, which were then transferred, as recommended, to
[648] the newly created Mortgage Institute. Efforts were made by the
[453] League to secure some measure of independence for the Central Bank from the State, and the State undertook to sell certain of its shares in the bank.[3] The scope of the bank's lending operations were strictly limited by the new Statutes. It was also granted the monopoly of the note issue, and the legal cover, which had previously been such as to encourage its commercial operations, was to consist as to not less
436 than 40 per cent. of gold or 'gold exchange'. Finally, the parity of
453 the new currency, the Estonian kroon, was fixed at that of the Swedish crown,[4] and the currency was put into circulation at the beginning of 1928.

Once *de jure* stabilization was achieved, the stability of these currencies was maintained throughout the period without recourse to official exchange restrictions. There was also a steady increase in the gold and foreign exchange holdings of the Central Banks, though, except in Lithuania, there was a tendency for reserves to fall towards

[1] The report of the Financial Committee of the League was issued in March, 1925: see League Document C. 240, M. 92, 1925, II.

[2] *Banking and Currency Reform in Estonia, May 25, 1927*: League Document C. 227, M. 89, 1927, II.

[3] According to Kisch and Elkin, op. cit., p. 27, a large proportion of its holding was sold in 1929.

[4] Giving a parity to the gold £ of 18·1595.

436 the end of the period. At all times, however, the cover for the note
453 circulation was well above the legal requirements. The position can be seen from the following table:

TABLE 27. *Gold and Foreign Currency Reserves: Notes in Circulation*

End of	Estonia* (kr.) Central Bank		Latvia (lats) Central Bank		Lithuania (lits) Central Bank	
	Gold and foreign currency reserves	Notes in circulation	Gold and foreign currency reserves‡	Notes in circulation†	Gold and foreign currency reserves	Notes in circulation
1922	..	37	45	54	33	30
1923	14	34	67	63	66	60
1924	13	36	71	68	94	93
1925	13	35	53	61	64	82
1926	14	34	55	62	69	87
1927	22	39	76	71	86	97
1928	31	36	101	77	80	85
1929	27	34	80	83	113	95
1930	23	32	65	86	125	117

* The figures for 1922–6 are obtained by revaluing the original figures, which are given in Estonian marks, at the official rate of conversion into kroon (100 Estonian marks = 1 kroon).

† Including the Treasury note issue. ‡ Including those held by the State.

2. FOREIGN DEBT

● 457 The Baltic States all suffer from lack of capital, and it was therefore inevitable that during this period there should be some borrowing abroad. This borrowing, however, was not excessive, and the meeting of the foreign debt service has never been as difficult a problem as, for example, it has been in Central and South-East Europe. But no account of the economic and financial structure of these States would be complete without some description of the foreign debt.

The position at the end of 1930, by which point foreign indebtedness had probably reached its greatest dimensions,[1] can be seen from the following table, based on figures taken from the League of Nations Memorandum on *Balances of Payments* for 1933. The capital raised during the period is represented largely by items 2 and 4. No data are available for estimating Estonia's private short-term debt, but from figures given in this publication for subsequent years it appears to have been small, if not negligible. It will be seen that, while the per head foreign indebtedness in Estonia

[1] Lithuania, however, obtained a loan from the Swedish Match Co. in 1930, payments to Lithuania in respect of which continued to be made until 1932.

and Latvia is roughly the same, that of Lithuania is very much smaller: 457

TABLE 28. *Gross Foreign Indebtedness*

(In million Swiss francs)

	Estonia	*Latvia*	*Lithuania*
1. Inter-governmental debt	114·0	85·1	36·2
2. Other Government and municipal debt	51·7	31·1	37·7
3. Foreign long-term investments in banks, industry, &c.	45·8	104·8	33·6
4. Private short-term debt and other debt	?	137·3	15·9
Total	(211·5)	358·3	123·4
Total per head of population (Swiss frs.)	(190·9)	177·0	49·0

Inter-governmental debt consists chiefly of War and relief debts, mainly to the U.S.A. and the United Kingdom. These debts were funded, mostly between 1925 and 1928, as follows (figures in millions):

	To U.S.A.	*To Great Britain*
Estonia	$13·8	£1·2
Latvia	$ 5·6	£2·3
Lithuania	$ 6·0	£0·2

In addition, there are a number of small inter-governmental debts similar in origin, such as the Lithuanian debt to France, Italy, and the United Kingdom, for the occupation and administration of the Memel Territory. A certain amount of other small debts arising from the War were repaid during the period and are therefore not included in the above tables, e.g. the Latvian relief debts to Norway and Estonia. On the whole, the liabilities assumed by these States in respect of the War were not large, especially in view of the considerable services which they represented. Interest and capital repayment on all the larger War and relief debts, and on most of the smaller inter-governmental debts not referred to in detail above, have been suspended since 1932.

The other foreign debt of these Governments is small. Estonia was the only country to make an international public issue, the 7 per cent. Banking and Currency loan of 1927 brought out under the auspices of the League of Nations.[1] Lithuania, however, obtained in 1920 a loan of $1·8 millions (the 5 per cent. Liberty Loan), which was subscribed privately by Lithuanians in the U.S.A. and used for reconstruction purposes. Apart from this, the foreign debt of the three Governments consists almost entirely of three loans received from the Swedish Match Trust towards the end of the period. In

[1] For the details of this loan, see above, pp. 133.

457 each case the loan was made in return for the cession to the company of the match monopoly. The loan to Latvia was made in 1928 and is repayable by 1964. The total nominal amount was $6 millions, interest being payable at 6 per cent. The proceeds were used largely for public works, the cost of which had led to a budget deficit,[1] and for advances to agriculture. The loan to Estonia was made in 1930, its total nominal amount being 7·6 million Swedish krone; interest is payable at 6 per cent. and the loan is redeemable by 1958. Lithuania obtained her loan a few months later; she was to receive $6 millions in three annual instalments, interest being payable at 6 per cent. Redemption was to take place by 1965. Only two instalments were received, however, and in 1935 it was agreed that the nominal amount of the loan should be reduced to $4·5 millions, and the rate of interest to 4½ per cent. The proceeds were used for long-term loans to agriculture and public works. It may be added that Riga's refusal to recognize liability for the loan issued in London before the War[2] was an obstacle to any attempt by Latvia to obtain a loan in the London market during the period, while Lithuania was perhaps not considered a good risk owing to the Vilna and Memel questions.

As can be seen from Table 28 above, the rest of the foreign indebtedness consists of foreign investments in banks and industrial enterprises. To some extent the figures given in this table represent investments made long before the War, but for the most part they relate to this period. The reason for the comparative importance of this item is simply that, in countries so short of capital as the Baltic States, any major plan of development such as, for example, the building of a power station, or any activity requiring large sums of liquid capital such as banking, are almost impossible without foreign assistance. Full comparable details as to the countries chiefly interested in the Baltic States are not available. Table 29 opposite may, however, be of interest.

Figures are not available for Estonia, but here the greatest single creditor country is probably the United Kingdom, followed by Sweden and Germany. A considerable interest, however, is held by the Netherlands.

The industries in which the greatest amount of foreign capital is invested are probably textiles and chemicals; at any rate in Latvia and Estonia, British, Swedish, and German capital being largely represented. The British Overseas Bank, Ltd., of London, is interested in banking in Estonia and Latvia, while a small amount of German capital is invested in the banks of these two countries. In Lithuania, where, as will be seen, the banking system is rather different from that of the two other countries, there is not a great

[1] See below, p. 139. [2] But see below, p. 262.

1: Anonymous U-4 (no date)1938 RB1 Baltic States RB2

TABLE 29. *Details of Foreign Indebtedness*

457

Latvia (end of 1930) *Distribution by creditor countries of nominal (paid up) participation in Latvian joint stock companies* *(In million Swiss francs)*		*Lithuania (end of 1933)* *Distribution by creditor countries of nominal (paid up) participation in, and long-term loans to, Lithuanian enterprises** *(In million Swiss francs)*	
Germany	25·7	Sweden	10·2
Great Britain	16·1	Belgium	8·9
Sweden	11·8	Great Britain	7·2
Netherlands	8·4	Germany	5·3
Belgium	7·3	U.S.A.	2·3
Tsarist Russia	7·1	Netherlands	1·7
Estonia	6·6	Latvia	1·7
U.S.A.	5·3	Others	1·0
Others	16·5		
Total	104·8	Total	38·3

* See *Lithuanian Telegraph Agency (Elta) Service*, February, 1935.

deal of foreign capital invested in banks, though what there is is largely German, and relates principally to the Memel Territory. Of the other industries in which foreign capital has played an important part during this period may be mentioned the metallurgical and leather industries in general; in Estonia the plywood (Venesta Ltd.) and shale-oil industries (New Consolidated Goldfields, Ltd.), and in Latvia and Lithuania the paper industry, British capital being chiefly interested in both cases. Lastly, a Belgian concern is interested in a power station operating in Kaunas.

3. PUBLIC FINANCE

652

It was some years after the War before order could be established in public finance. Apart from the problem of financing the many extraordinary calls on public expenditure, there were various other difficulties which led to much confusion. Of these perhaps the most serious was the task of creating and developing financial systems where none had existed before. In this the lack of persons with administrative experience was an additional hindrance. Moreover, the monetary chaos of the time made any form of budgeting or accounting extremely difficult. On the other hand, the Baltic States, unlike some of the new countries of Central and Eastern Europe, did not start their existence with a legacy of foreign indebtedness inherited from previous régimes. In the circumstances it was, perhaps, inevitable that there should be a period of currency inflation, though it is sometimes difficult to establish how far these States were themselves responsible for this inflation, and how far it was due to inflation in the countries whose currencies they were using at the time. Towards the middle of this period, however, the need for

652 State had begun to encroach upon the field of private enterprise. The implications of this movement will become clear when the period after 1931 is considered.

4. The Banking System

453 Before the War banking had been fairly highly developed in Estonia and Latvia. The centre of the system, however, was naturally St. Petersburg. There was a considerable number of commercial banks in most of the more important towns of the Baltic Provinces, mostly with head offices in that city. Indeed, it was a frequent complaint that the commercial banks invested an excessive part of the deposits which they drew from the Baltic Provinces in [454] other parts of the Empire. These banks were largely concerned with the foreign trade conducted through Riga, Reval, and the other large ports and, to a lesser extent, with the financing of industry. In addition, since the beginning of the century, the Russian authorities had done something to foster the growth in all three countries of mortgage institutes for local requirements, and of municipal banks. The mutual credit association, also, was beginning to become popular.

The War, of course, destroyed this system. Liquid assets held in the branches were withdrawn to the head office, records were destroyed, and finally, in many cases, the parent institution ceased to exist. But the system left its mark on the Baltic States. For, when these States began to develop banking systems of their own, an unusually clear distinction was drawn between the function of the commercial banks and that of the other units of the system. Banking during this period grew up largely on the principle of the specialization of functions; and, even in Lithuania, where financial technique is less developed than in the other countries, there is a comparatively large number of categories of banks. Thus, in addition to joint stock commercial banks proper, there are usually to be found private banks, rural and urban credit institutions, mutual credit associations, and municipal banks, apart from the banking apparatus of the co-operative system.

In spite of this diversity of types, there is nothing in the Baltic States which corresponds to a money market, and the credit system is directly dependent on the central bank. This usually tended to render credit expensive, and during most of this period the rate of interest was considerably higher than in Western Europe. It would ● [457] certainly have been higher still but for the fact that the investments of foreign banks in the commercial banking systems of the Baltic States were substantial, and foreign credits were therefore easy to obtain at comparatively cheap rates. This, together with the return of more normal conditions after the War, led to a noteworthy expansion of

commercial banking, particularly in Estonia and Latvia, which continued to the end of this period. The expansion was not accompanied by any extension of the principle of branch banking, which rarely occurs, but, perhaps for this reason, a large number of smaller banks came into being. 453

Commercial Banks. In Estonia and Latvia these banks were often created out of the business of banks which had existed before the War, though in a few cases there were joint stock commercial banks, and occasionally private banks, which survived the War. In Lithuania nearly all the more important commercial banks were created after the War. In all three countries the joint stock form is usual. The commercial banks are to a very large extent concerned with financing foreign trade, and, probably for this reason, the commercial banking system of Estonia and Latvia is more highly developed than that of Lithuania. They do to some extent finance local industries, though not to the same degree as in Central Europe, and their long-term loans to industrial undertakings are comparatively small. The interest of foreign capital in this type of bank is considerable. The United Kingdom and Germany have the greatest participation in the commercial banks of Estonia and Latvia; Germany, however, is the only foreign country with any substantial investments in Lithuanian banking. The fact that the banks which finance foreign trade are themselves often financed largely by foreign capital was of great importance to those States during the period, for there is little doubt that foreign trade would not have developed so fast if foreign credits had not been available in this manner. In the event, commercial banking expanded very rapidly. Indeed, the scarcity of capital during this period often compelled these banks to work on a basis which might well be called overtrading. The following table,[1] shows the position at the peak of this period of expansion: 453 457

TABLE 31. *Position of Commercial Banks*

	Estonia as at 1.12.30	*Latvia as at 31.12.29*	*Lithuania* as at 31.12.29*
Number of Banks	40	20	9
	(mill. kr.)	(mill. lats)	(mill. lits)
Total assets	194·0	199·7	60·4
Cash	4·0	7·2	3·4
Loans and advances	86·6	86·2	23·7
Paid-up capital and reserves	15·6	33·7	13·4
Deposits	96·0	61·6	33·6

* Excluding Memel.

[1] Based on figures given in the League of Nations, *Memorandum on Commercial Banks, 1929–1934*, Geneva, 1935.

PART II. THE CRISIS OF 1931 AND SUBSEQUENT DEVELOPMENTS

INTRODUCTION

THE economic system built up by the Baltic States during the period which ended in 1930 was highly sensitive to tendencies in the outside world. In other words, the system depended very largely on the maintenance of prices at or around the levels of the years 1925–30, and still more on the ability of the chief markets to continue to absorb Baltic exports. The system also presupposed that foreign capital would be available to finance foreign trade and, eventually, the larger schemes of development for which money was lacking at home.

The crisis of 1931 swept away these assumptions. There was first a catastrophic fall in the price of all the commodities produced by these States. Simultaneously the principal markets, the United Kingdom and Germany, began to restrict their imports from the Baltic countries. The result was a considerable fall both in the exchange available for imports and in the exchange reserves held by the Central Banks. This led, in turn, to the imposition of exchange restrictions and, in Estonia and eventually in Latvia, to the abandonment of the currency parities introduced after the War. Meanwhile, in order to save foreign exchange, imports had to be reduced to a small fraction of the figures attained before the crisis, with a consequently severe effect on the whole productive system. Finally, budgets were thrown into deficit and there was a general increase in public internal indebtedness.

During the years which followed 1931 the Baltic States have been adjusting themselves, gradually, and on the whole with a considerable degree of success, to the new conditions which have since prevailed. The process of adjustment has been immensely assisted by the fact that, unlike most of the States of Central and Eastern Europe, the Baltic countries did not accumulate an excessive amount of foreign indebtedness in the years before the crisis. On the contrary, one of the chief differences between the effect of the crisis in the Baltic and that in the Balkans, for example, is that none of the Baltic States has defaulted on its foreign debt.

For countries as small as the Baltic States, a policy directed towards the greatest possible isolation from the outside world—such as that pursued by Italy or Germany—was obviously out of the question. Nevertheless, the adjustment has been accompanied by a complete reorganization of the productive system. Estonia and Latvia, in order to economize exchange, have increased their production of cereals, which, as a general rule, they now no longer import. Latvia

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TABLE 38. *Number of Workmen Employed in Manufacturing Industries*[1]

Industries	Estonia (enterprises employing 20 or more workers only)		Latvia (all workers)	
	1926	1937 (end)	1926	1937 (end)
Textiles	8,919	12,024	5,935	16,394
Woodworking	4,389	3,567	10,061	12,758
Metallurgical	3,758	6,384	8,406	19,541
Paper and printing	3,349	3,909	5,132	6,801
Foodstuffs	1,916	3,284	8,543	16,648
Chemical	835	2,831	3,433	5,182
Other	2,683	12,584	8,160	25,655
Total	25,849	44,583	49,672	104,979

in construction. In Latvia the increase in 'other' industries is chiefly due to the growth of activity in the clothing trade, employing over 13,000 at the end of 1937, and in building.

So far as the volume of industrial production is concerned, some indication as to developments in these two countries can be obtained from the following figures:

TABLE 39. *Indices of Industrial Production*

(1930 = 100, average for year)

	All commodities		Capital goods		Consumption goods	
	Estonia	Latvia	Estonia	Latvia	Estonia	Latvia
1930	100·0	100·0	100·0	100·0	100·0	100·0
1931	92·0	82·0	92·6	83·0	91·3	80·1
1932	79·3	75·7	78·1	53·4	78·4	78·1
1933	83·0	102·7	81·2	63·6	81·5	109·3
1934	97·7	119·6	106·3	83·3	91·5	126·9
1935	107·8	126·1	114·9	88·0	101·6	134·3
1936	121·6	131·5	133·0	103·7	112·5	138·3
1937	140·5	147·8	174·1	121·0	119·5	151·3

Estonia. Developments in Estonia's manufacturing industry since 1930 were subject to the general considerations mentioned above. Additional stimulus to industry was given by the introduction of severe import restrictions in the autumn of 1931 and of the control of the foreign exchanges. Moreover, the abandonment of the gold standard in June 1933 made it cheaper to buy raw materials abroad and to manufacture the finished article in the country than to import finished goods; and this greatly increased the development of industry. Finally, the increase in the purchasing power of the agricultural population, owing to the higher prices prevailing since 1935, led

[1] For the sources for the 1926 figures see note to Table 21, p. 117; the figures for 1937 are taken from *Eesti Statistika* for February 1938, and *Mäsla Bijetins* for March 1938.

working for export, especially the timber and plywood industries. This was followed by a general decrease of activity throughout the industries supplying the home trade, such as the textile industry, owing to the fall in agricultural purchasing power arising out of the decrease of exports. This movement was further accelerated by the credit crisis of 1931 and the moratorium on banking withdrawals; and by 1932 the monthly average total of unemployed was well over 14,000.[1]

Meanwhile, in the autumn of 1931 there was a general increase in Customs duties, and a system of import quotas and exchange restrictions was introduced. All these measures greatly increased the tendency towards industrial self-sufficiency, which now became the acknowledged policy of the Government. There was consequently a considerable increase in the activity of the consumption industries, especially the textile sections, which, as in Estonia, increased their consumption of home-grown flax. This led in turn to an increase of activity in the production goods industries. At this stage the export industries began to experience a recovery, and by the end of 1934 the building boom in the United Kingdom began to have an appreciable effect on the plywood industry and saw-mills. There was also a marked recovery in the paper and cellulose industry.

Up to this point industrial expansion had followed the normal course of recovery from a severe recession. This recovery had taken place for the most part within the limits of the existing industrial apparatus. Few fresh industries had been started, and the relations existing between industry and the State before 1930 had, for the most part, been maintained. The advent of the totalitarian system in 1934, however, has been followed by an entirely new industrial policy. This policy does not consist merely in an attempt to attain the greatest degree of self-sufficiency. Its purpose would seem rather to be the introduction of a form of State capitalism or, at any rate, a system in which the State is able to exert direct control over the industrial organization. It will be seen how the State, by its relation to the co-operative system, is able to exert a considerable degree of control over agriculture and dairy farming. This, however, is a policy which the State is generally compelled to pursue in a poor country of small farmers. That such a policy should be applied to a relatively large industrial organization, which had hitherto relied on private enterprise, was a considerable innovation.

The policy began to be put into effect first through the *Latvijas Kreditbanka*,[2] a commercial bank formed by the State in 1935. By the purchase of majority shareholdings, this organization soon

[1] i.e. demands for work according to the official returns.

[2] On this, see further pp. 184-5.

471 652 658 acquired a considerable interest in industries of a very varied nature, in determining the policy of which it is naturally instigated by the desires of the State. During 1936 and 1937, however, the State itself has been acquiring a direct shareholding interest in a number of concerns, of which may be mentioned a large metallurgical works in Riga, and a large brick factory. Even in the timber industry the Government is in a position to control auction sales, and is itself an exporter. Almost the only branch of industry which has so far remained free from the direct or indirect influence of the State is the textile manufacturing industry.[1] How far this policy will be pursued [185] it is impossible to say. The President stated in April 1937 that the Government wished the entire Latvian population to participate in the progress of industry by taking a direct shareholding interest, and appealed to the public to purchase shares in the new State brickworks, even suggesting that the State might guarantee dividends.

433 457 *Lithuania.* Developments in Lithuanian industry since the crisis have been on the whole inconsiderable. Though severe restrictions were placed on imports in 1935, the existing industrial system was too small to bear the strain of a thoroughgoing policy of self-sufficiency, and, in any case, the lack of foreign exchange and foreign credit has prevented the import of sufficient plant to make it possible. Nevertheless, there has been some expansion in the textile industry since 1930, and in 1936 there were as many as 5,000 persons employed in this branch, though the figure includes those employed in Memel. The result has been some decrease in the import of textile piece goods and an increase in the import of yarns and raw materials. [477] A further development of some importance has been the growth of trusts and combines, mainly in the foodstuffs and brewing industries, which have arranged for the regulation of output and the fixing of prices.[2]

II. FOREIGN TRADE AND BALANCE OF PAYMENTS, 1931–7

1. General Movement

439 It has been seen that the foreign trade of Estonia and Latvia had already begun to decrease before 1931. With the onset of the financial crisis of that year, the decrease in the trade of all three countries rapidly gathered momentum. The value of exports (expressed in Swiss francs) did not finally reach their lowest level until 1933 for

[1] The State, however, has recently taken an interest in a newly formed company concerned with the production of woollen textiles (*Frankfurter Zeitung*, August 21, 1937). It may be added that the State is interested also in shipping; see below, Appendix II, p. 191.

[2] Details are given in D.O.T.: *Economic Conditions in Lithuania, November, 1935*, publ. 1936, pp. 15–16.

439 to results similar to those arising out of Germany's clearing agreements, for example, with Greece, Turkey, and Yugoslavia. The German clearing agreements with Estonia and Lithuania seem to be working in a normal manner.

Trade with countries other than Germany and the United Kingdom continues to be of minor importance. There was a further decrease in the relative proportion of inter-Baltic trade,[1] for reasons already noted, while there was a tendency for trade with the Scandinavian countries, particularly Sweden and Finland, to increase, no doubt because the latter two countries belong to the 'sterling bloc' and their currencies are convertible. There was a tendency also for the relative value of exports to the U.S.A. to rise, probably for the reason which encouraged exports to the United Kingdom. With most of the other countries trade is conducted by means of compensation or clearing agreements. Apart from this, the only development of importance was the decrease of Estonia's and Latvia's imports from, and the increase of Lithuania's exports to, the U.S.S.R.; in all three cases political considerations played some part; Latvia's exports to the U.S.S.R. fell off very considerably after the expiry of the commercial agreement in 1932. Political considerations, also, continued to be responsible for the low level of commercial intercourse between Poland and Lithuania.

4. The Balance of Payments

● 457 In Part I it was shown that during the latter part of the period 1919–30 the Baltic States were importing capital, and that there was generally a deficit on current account. The import of capital ceased in 1931, and, owing to the shortage of exchange, efforts were made to reduce the proportion borne by merchandise imports to exports. The success of these measures can be judged from Table 49 opposite.

457 As the result of the commercial policy pursued since 1931, Estonia
439 has become a country with a surplus of merchandise exports, except in unusual years like 1936 or 1937; Latvia has considerably reduced her import surplus and occasionally, as in 1932, 1936, and 1937, has an export surplus, while Lithuania has increased her export surplus. These changes have fundamentally altered the balance of payments, for the effects of the crisis greatly reduced the chief net invisible exports; and, if radical changes had not been effected in the merchandise account, there would probably have been a deficit in current account, which, as it could no longer be made good

[1] In the summer of 1937 the commercial treaty between Estonia and Latvia was denounced, and Estonia included a 'Baltic clause' in a commercial treaty then signed with Finland. For the Baltic clause, see above, pp. 127–8.

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y capital imports, would probably have led in turn to currency epreciation. In the event, most years up to 1936 closed with a rplus, as can be seen from the following summarized table: 457 [439]

TABLE 49. *Balances of Payments*

CURRENT ITEMS
(In million Swiss francs)

	Estonia				*Latvia*				*Lithuania*			
	Merchandise and bullion (net)	*Interest and dividends (net)*	*Other items (net)*	*Balance*	*Merchandise and bullion (net)*	*Interest and dividends (net)*	*Other items (net)*	*Balance*	*Merchandise and bullion (net)*	*Interest and dividends (net)*	*Other items (net)*	*Balance*
929	− 9·2	−8·3	+4·7	−12·7	−50·1	−8·9	+30·7	−28·3	+ 6·9	−2·7	+21·2	+25·4
930	− 4·9	−9·0	+5·1	− 7·8	−15·5	−6·0	+28·7	+ 7·2	− 7·8	−5·0	+13·0	− 0·8
931	+12·9	−6·9	+7·8	+13·8	− 3·6	−5·9	+17·0	+ 7·3	−30·4	−5·2	+13·9	−21·7
932	+ 8·0	−7·2	+4·0	+ 4·8	+12·6	−5·3	+11·3	+18·6	+ 5·7	−4·0	+11·6	+13·5
933	+ 7·9	−8·4	+3·3	+ 5·8	−13·8	−4·1	+ 9·3	− 8·6	+ 3·5	−3·1	+ 2·9	+ 3·3
934	+11·6	−3·8	+1·9	+ 9·7	− 5·1	−3·8	+ 9·1	+ 0·2	− 2·7	−1·6	+ 7·2	+ 3·0
935	+ 8·6	−3·7	+2·9	+ 7·8	+ 1·2	−4·3	+ 7·4	+ 4·3	not available			
936	− 4·4	−2·3	+5·3	− 1·4	+13·0	−3·1	+ 5·6	+14·5	not available			

As regards the details of the chief changes since 1929, the position an be seen from Table 50 on p. 170, in which the figures for that year are compared with those for 1935 and 1936 in the case of Estonia and Latvia, and for 1934 in that of Lithuania, these being the latest years for which data are at present available.

Principal Changes. The chief change has been the reduction of net payments in respect of interest and dividends. This is due to the suspension since 1932 of instalments on War and relief debts, but also to the depreciation or devaluation of the currencies in which the other debts are expressed. There has been no default on any of the foreign debts of these States. On the contrary, interest payments were resumed in 1934, though at a lower level than was provided in the loan contract, on the foreign debt of the City of Riga.[1] A further development of importance was the substantial fall in receipts from the transit trade, from which Latvia in particular has suffered. This was due to the general decrease of foreign trade since 1929 and especially to the fall in shipments from the U.S.S.R. via Riga. The Latvian and Estonian finishing trades also suffered considerably. Lithuania was severely affected by the decline in emigrants' remittances from the U.S.A., her only invisible export of any importance.

It is improbable that there have been any material changes in the last two years. The Latvian abandonment of the gold standard in September 1936 will, of course, have increased the cost of the foreign debt service, but this must be offset by the increase of foreign trade since that date, which has almost certainly led to an increase in the

[1] See further p. 182.

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TABLE 50. *Balances of Payments (in detail)*

CURRENT ITEMS

(In million Swiss francs)

	Estonia			*Latvia*			*Lithuania*	
	1929	*1935*	*1936*	*1929*	*1935*	*1936*	*1929*	*1934*
I. *Merchandise* (net)								
Merchandise	− 7·5	+9·5	− 3·1	−88·1	− 2·1	+12·3	+ 9·1	+4·5
Adjustments:								
(a) Ships purchased abroad	− 1·8	−0·9	− 1·3	− 5·2	+ 0·4	− 0·7	..	..
(b) Other adjustments	..	..	..	+43·3*	+ 3·0	+ 0·5	− 2·1	−7·1
II. *Interest and Dividends* (net)								
Interest on inter-governmental debt	− 2·6†	−1·5†	− 1·5†	‡	..	..	− 1·1	..
Interest on other public debt	− 2·8	−0·4	− 0·3	− 1·9	− 1·0	− 0·5	− 1·0	−1·6
Interest, &c. on other long- and short-term debt	− 2·8	−1·8	− 0·4	− 4·0	− 3·3	− 2·6	− 0·6	+0·1
III. *Other Items* (net)								
Shipping freights	+11·1	+5·8	+11·2	+10·0	+11·9	+11·7	..	+0·2
Port fees, &c.	− 5·7	−4·6	− 6·6	+ 1·0	− 9·3	− 8·3	+ 0·2	+0·1
Transit fees, warehousing, &c.	+ 0·4	−0·1	..	+12·1	− 0·9	− 2·0	+ 3·8	+0·2
Insurance	− 0·3	−0·4	− 0·3	− 0·2	− 0·5	− 0·9	+ 1·5	−1·0
Banking commissions, &c.	§	§	§	§	§	+ 0·6	+ 0·1	+0·2
Post, telegraphs, and telephones	+ 0·8	+0·2	+ 0·2	..	+ 0·2	− 0·1	+ 0·7	+0·3
Immigrant and emigrant remittances	− 1·4	..	..	+ 8·0	+ 1·3	+ 1·3	+14·8	+6·2
Tourist expenditure	+ 0·1	+0·1	+ 0·7	− 1·6	+ 2·5	+ 1·7	− 0·9	+1·1
Diplomatic expenses	+ 0·7	+0·2	− 0·1	+ 3·2	+ 2·4	+ 2·1	− 0·2	−0·1
Other Government receipts and expenses	− 0·7	−0·9	+ 0·2	+ 0·9	..	..	+ 0·6	−0·1
Other current items	− 0·3	−0·2	− 0·1	− 2·7	− 0·2	− 0·5	+ 0·6	+0·1
IV. *Bullion*	+ 0·1	..	..	− 0·1	− 0·1	− 0·1	− 0·1	−0·1
Balance	−12·7	+7·8	− 1·4	−25·3	+ 4·3	+14·5	+25·4	+3·0

* Adjustment for wrong valuation.
† Including payments in respect of the League Loan.
‡ Included in capital account.
§ Included in 'Interest on other long- and short-term debt'.

[*Note*: The figures for individual items above are probably not strictly comparable as between country and country, but they do form a rough basis for comparison.]

net invisible exports such as shipping and the transit trade. From this Estonia, too, should have benefited, though, on the other hand, there has again been an excess of merchandise imports in 1937. As regards Lithuania, the improvement of conditions in the U.S.A. during 1936 and the first half of 1937 may be assumed to have resulted in an increase of emigrants' remittances in the last two years, while the improvement of economic relations with Germany should have a beneficial effect on the other invisible items. There can be little doubt that in each case there was a surplus on current account during 1937.

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III. THE FINANCIAL SITUATION

1. The Exchanges and Monetary Policy, 1931–7

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The general principle upon which currency stabilization had been effected in the Baltic States was, briefly, that central banks should hold gold or foreign exchange reserves sufficient to offset any temporary adverse movements in the balance of payments which could not be covered by capital imports. These reserves were naturally not large enough to meet withdrawals of foreign capital on a large scale; and it cannot be said that they were intended to be. By the end of 1930 it had become impossible to import capital owing to conditions on foreign money markets. Moreover, the reduction of foreign trade was leading, as has been seen, to serious deficits in the balance of payments. The German crisis, which began in July 1931, was followed in the Baltic States by an entire loss of confidence, and to some extent by a withdrawal of German and other foreign capital, leading quickly to a considerable amount of domestic withdrawals. Finally, the collapse of sterling in September of that year led to conditions bordering on panic, for in Estonia, and to a smaller degree Latvia, the foreign exchange reserves of the Central Banks had been held largely in sterling, and to that extent were reduced proportionately with the fall of the pound.

All these events struck at the very principle upon which the Baltic currencies had been stabilized, but the policy adopted to meet them has varied considerably from country to country. In Estonia and Latvia official exchange restrictions were adopted in the autumn of 1931; but Lithuania was able to avoid this step until 1935. Again, Estonia decided to abandon the gold standard and join the sterling *bloc* in the summer of 1933, but Latvia did not follow her example until September 1936, while in Lithuania the external value of the currency has been maintained at the same level ever since the stabilization of 1922. Lastly, the general improvement in world economic conditions since 1933 has been reflected very differently in the currency systems of these three States. It will therefore be necessary to examine the position in each country separately.

Estonia. In Estonia exports had tended to decrease since 1928, but imports had been reduced, and there was a comfortable surplus of merchandise exports in 1931. Invisible exports also exceeded invisible imports in that year. It might therefore be asked why a currency crisis should have arisen at all. The answer would be that it was largely a crisis of confidence. The German catastrophe of July 1931 had been followed by withdrawals of German capital, and a flight from the kroon by Estonian nationals. Moreover, a large proportion of the *Eesti Pank*'s foreign exchange reserves consisted of

sterling, and the loss on the abandonment of the gold standard by Great Britain was considerable. Even before 1931 these reserves had been allowed to fall to a low level, and it was clear that, if sterling continued to depreciate, they would soon fall below the minimum required for safety.

At this stage the alternatives before Estonia were to abandon the gold standard like the Scandinavian countries—the kroon, it will be remembered, was based on the Swedish crown—or to impose a system of exchange control. Estonia, however, had not sufficient resources to justify taking the chances with her currency which the former alternative seemed to involve, especially in the uncertainties prevailing during the autumn of 1931. Moreover, the abandonment of the gold standard, it was felt at the time, might lead to currency inflation, the disastrous effects of which Estonia had already experienced once. It is not surprising, therefore, in the circumstances, that unofficial exchange restrictions were introduced early in October, though official control of the exchanges was not put into effect until November 19, 1931. The restrictions were constantly made more rigid throughout the year that followed. With their help, and that of the increased restrictions on exports, the gold value of the currency was maintained at its legal level.

It gradually became clear, however, that this was a somewhat empty achievement. The example of Germany was beginning to show the difficulties to which exchange control leads. Moreover, maintenance of the original value of the kroon penalized Estonia's exports to Great Britain, and placed her in a poor position to compete with other exporters of dairy produce and timber in countries which had depreciated their currencies. It was gradually recognized, therefore, that a mistake had been made. In December 1932 it was decided to impose an *ad valorem* tax of 15 per cent. on sales of foreign exchange to importers, &c., the proceeds of which were allocated to a fund established for subsidizing exports. The depreciation of the dollar in March 1933 considerably lightened the burden of Estonia's foreign debt, and it thus became possible to go even farther. On June 28, 1933, the gold standard was abandoned, and the external value of the kroon was reduced to that of the Swedish crown, involving a depreciation, at that stage, of about 35 per cent. Finally, during the following autumn it was decided to base the external value of the Estonian kroon directly on that of sterling, with which currency the kroon has since fluctuated.[1]

[1] According to the League of Nations *Memorandum on Commercial Banks, 1935–6*, Geneva, 1936, p. 74, the gold held by the *Eesti Pank* at the time of the abandonment of the gold standard, viz. 19 million kroon, has not yet been revalued. A substantial profit should eventually accrue to the State therefrom.

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Latvia

There is little doubt that the general improvement which followed was due to the abandonment of the gold standard. Wholesale prices began to rise appreciably enough to give some relief to producers, but not sufficiently to offset the effect of currency depreciation on foreign trade, for the value and volume of exports, especially to the United Kingdom, began to increase almost immediately. Lastly, as will be seen from the table at the end of this section, the exchange reserves also began to improve, and it was possible to relax the exchange restrictions considerably. It is true that restrictions are still in force, but their main purpose is to prevent the export of capital and the import of goods not considered to be essential to Estonia's economy; and they do not at present interfere very greatly with normal commercial transactions.

Latvia. In Latvia the decrease of foreign trade between 1929 and 1931 was very considerable, but the current items of the balance of international payments showed a surplus both for 1930 and 1931. As in Estonia, the extraordinarily severe financial crisis of the latter year was largely a crisis of confidence. The withdrawals of capital arising out of the German banking crisis of July were even heavier in Latvia than they were in Estonia, and there was an alarming decrease in the gold and foreign exchange reserves of the Central Bank. The amount of withdrawals, both foreign and domestic, was so large that regulations were introduced in the middle of July 1931 imposing strict limits on the proportion of deposits which might be withdrawn.[1] These difficulties were greatly increased by the abandonment of the gold standard in the United Kingdom, much of Latvia's exchange reserves being in sterling, and on October 8, 1931, a system of exchange control was introduced.

Although the banking moratorium was gradually relaxed, the severity of the exchange restrictions was constantly increased, and their scope was considerably widened. This process continued until 1935, and though, as will be seen, the currency was virtually allowed to depreciate in that year, the nominal gold parity was maintained up to September 1936. Since the economic structure of Latvia so closely resembles that of Estonia, which had abandoned the gold standard in June 1933 and greatly profited thereby, the question will arise why Latvia did not follow Estonia's example. It should, however, be pointed out that Latvia had experienced a severe credit crisis, whereas Estonia had not; and that this greatly intensified the common fear that the abandonment of the gold standard might be followed by a currency inflation similar to that of the period immediately after the War. Moreover, before the crisis, Latvia, unlike Estonia, had an habitual surplus of merchandise

[1] On the banking moratorium in Latvia, see further pp. 184–5.

459 imports, and it was felt, not without some justification, that until
652 this import surplus had been converted into an export surplus, or
458 at any rate substantially reduced, experiments with the currency would be inadvisable.

Whatever the reasons for Latvia's choice, its effects are plain. The Government was gradually led by the consequent deflation to extend the control which it now exerted over exchange movements, not only to almost every branch of production and trade, but to the credit system as well,[1] and to follow an economic policy very similar to that pursued by Germany for the same reasons. But it was clear that, though this system enabled the Government to maintain that the nominal gold parity of the lat was unaltered, it did nothing to improve foreign trade, and Latvian exports to Great Britain met with considerable competition from Estonia. The Latvian exchange policy was, consequently, modified so as to assist exports. The change took the form at first of a direct subsidy to exporters of the principal export commodities, such as butter. During 1935, however, a new system was introduced whereby the exporter received a premium in lats over the official price given by the control authorities for the exchange produced by his exports, and the importer had to pay a similar premium for the exchange required to pay for his imports. This premium at times rose to as high a figure as 35 per cent. In other words, the Government were virtually forced to admit that the external value of the currency had depreciated by roughly 25 per cent.

Nevertheless, although this admission was of some value to Latvia's foreign trade, the system introduced in 1931 was maintained until the end of September 1936. The almost simultaneous devaluation of the French and Swiss francs and the depreciation of the Dutch guilder gave the Latvian Government the opportunity of openly recognizing the depreciation in the external value of the lat without losing prestige.[2] On September 28 a law was passed fixing the parity of the lat at 25·2215 to the £, the parity existing before Great Britain abandoned the gold standard.[3] Since sterling has no fixed value in gold, this step on Latvia's part was equivalent to the abandonment of the gold standard; and from that date the lat has belonged, like

[1] On this point see further, p. 185.

[2] The difficulty of adhering to the currency policy which Latvia had chosen was shown shortly before the devaluations of September 1936 gave her this opportunity. In July 1936 it had become necessary for the Government to reduce the gold and foreign exchange cover for the note circulation from 50 per cent. to 30 per cent. of the total note issue, provided that the latter was less than 100 million lats. *Frankfurter Zeitung*, July 16, 1936.

[3] An exchange equalization fund was established in November 1936, to which was allocated some of the profit arising out of the writing up of the value of gold in the hands of the Government and the *Latvijas Banka*. Exactly how much of the profit was so used is not known.

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the Estonian kroon, to the sterling *bloc*. The exchange restrictions, however, have not been notably relaxed, and it is still necessary for Latvian importers to obtain an import licence, which usually carries with it a permit to receive exchange, though in practice the restrictions now interfere little with normal commercial transactions. 457 652 458

Lithuania. In Lithuania the immediate effects of the general financial crisis of 1931 were less severe than in the other two countries. The extent of foreign investment in the banking system was smaller, and the withdrawals which took place were not sufficient to lead to any great loss of confidence in the currency. Moreover, the loss on the abandonment of the gold standard in Great Britain was not so large as in Estonia or Latvia, for the gold reserves of the Central Bank were chiefly held in dollars and not in sterling. Thus, although the fall in the volume of foreign trade had been considerable, and there were some domestic withdrawals from the banks, there was no serious flight of capital. Large exports of capital did not, in fact, begin to take place until 1935, and it is significant that, though the current items of the balance of payments had led to an unfavourable balance in 1931 and 1932, and there was a corresponding decrease in the gold and foreign exchange holdings of the *Lietuvos Bankas*, official exchange restrictions were not introduced until October 1935. The inference must be, it would seem, that the reserves accumulated year by year up to 1930 were sufficient to offset current adverse movements, but not to cover a heavy export of capital.

The sudden deterioration of the position in 1935 was largely due to extraordinary causes. The dispute with Germany over Memel, as has been seen, led to an almost complete suspension of commercial intercourse with what had been Lithuania's best customer. Moreover, the increase of emigration to Palestine was responsible for capital withdrawals on a fairly considerable scale. Thus, though the Central Bank had avoided a loss on the devaluation of the United States dollar in 1933 by converting most of its dollar holdings into gold or other currencies before the dollar was devalued, its gold and foreign exchange reserves continued to decrease. By the end of September 1935 the margin above the 33⅓ per cent. required as cover for the note issue was negligible, and on October 1 exchange restrictions were at last introduced. With their help the original gold parity of the litas has since been maintained. [648]

It will be asked how this has been possible during a time in which Lithuania's chief competitors in the export market had the advantage of a depreciated currency. The reply seems to be that in Lithuania the fall of prices was greater than in the other two countries, and that,

457 652 458 so far as exports are concerned, this offset some of the advantages gained by Estonia and Latvia through currency manipulation. Moreover, most exports have gradually been brought under the control of Government agencies, direct or indirect, and in some cases, e.g. butter, considerable subsidies have been granted. Lastly, the standard of living is considerably lower in Lithuania than in the other two countries, and in Lithuania the peasant is perhaps readier than in Estonia or Latvia to accept the lower prices which he must ask if his goods are to compete in world markets. But, though Lithuania has thus been able to make the best of both worlds by retaining her share of the foreign market, and at the same time adhering to the gold standard at the old level, the situation is clearly artificial, and the fact that it is necessary to subsidize exports indicates that the claim that the old parity of the litas has been maintained is not strictly correct. It is therefore surprising that Lithuania did not, like Latvia, seize the opportunity to recognize the *fait accompli* in September 1936. But, both then and since, the Government has insisted that there will be no change in their currency policy, and meanwhile the restrictions have been maintained. No difficulties, however, have been made by the authorities up to the present in supplying foreign currency for legitimate commercial transactions.

Developments during the period can be seen from the table opposite.

2. Public Finance

652 The budgetary position of all three States was, of course, severely affected by the crisis. The fall of agricultural prices rendered the collection of taxes difficult, and the general decrease in activity led also to a decrease in the revenue from indirect taxation, particularly from import duties. Ordinary expenditure, on the other hand, could not always be reduced *pari passu* with revenue, and, though very considerable economies were made, budgets were thrown into deficit. At the same time, though extraordinary expenditure was greatly reduced by the suspension of expenditure on public works, the State was obliged to spend considerable sums, usually outside the budget, on assisting the economic system by subsidies and other similar measures. During the last year or two, however, the increase of activity has led to a considerable improvement in ordinary budgets. But with this improvement there has been no reduction of the direct interest which the State had taken during the crisis in various branches of economic activity. On the contrary, the direct part thus played by the State has considerably increased in importance, at any rate in Estonia and Latvia, though the relevant figures do not always appear in the budgets.

1: Anonymous U-4 (no date)1938 RBl Baltic States RBl
Estonia

TABLE 51. *Position of the Exchanges*

	Exchange Reserves of Central Bank in millions (at end of year)			External value of currency expressed as a percentage of gold parity (average for year)
	Gold	Foreign Exchange	Total	
Estonia: (kr.)				
1929	6	21	27	99·8
1930	7	16	23	96·6
1931	7	15	22	99·8
1932	15	5	20	100·2
1933	20	2	22	82·4
1934	28	4	32	62·1
1935	34	2	36	60·1
1936	34	9	43	60·8
1937	34	17	51	60·4
*Latvia:** (lats)				
1929	24	56	80	99·9
1930	24	41	65	100·0
1931	32	15	47	99·9
1932	36	12	48	100·0
1933	45	3	48	99·2
1934	46	4	50	96·3
1935	46	7	53	98·7
1936	77†	28	105	89·6‡
1937	77†	43	120	60·0
Lithuania: (lits)				
1929	35	78	113	99·7
1930	39	86	125	100·1
1931	50	33	83	100·2
1932	49	16	65	100·3
1933	52	15	67	100·1
1934	52	8	60	100·0
1935	36	18	54	100·0
1936	73	10	83	99·7
1937	79	6	85	99·4

* Gold holdings include gold held by the Government.
† After revaluation on the abandonment of the gold standard.
‡ Until the end of September the old parity of the lat was maintained in theory.

Estonia. Developments in recent years are shown in Table 52 on p. 178.[1]

The decline in ordinary revenue from the figure reached in 1928–9 was offset by a considerable reduction in ordinary expenditure effected during 1932. In that year salaries of officials were reduced by from 4 to 26 per cent., and large savings were made on repairs, renewals, and the purchase of materials. In spite of these measures,

[1] Most of the figures in the following tables and the information in this section are taken from the League of Nations: *Memorandum on Public Finance, 1928–1935*, Geneva, 1936–7, to which reference should be made for fuller details. Figures for Estonia in 1935–6 are taken from an article by the Assistant Minister for Economic Affairs, M. A. Keller, in *The Banker* for March 1938.

652 but it is probably large, and it is clear that there can be no substantial decrease so long as the Government continues to pursue its present exchange policy.

3. Foreign Debt

● 457 Since 1930 no long-term loans have been contracted abroad by these States, and in all cases the service of existing loans, except that of War and relief debts,[1] has been maintained.

City of Riga Loan. The principal development during the period was the recognition by the Municipality of Riga of its responsibility for a loan contracted in London before the War, which did something to rehabilitate Latvia's credit. The total nominal amount of this loan was originally £1,322,700, bearing interest at 4½ per cent., and the whole issue was made in London in 1914 when Riga was a part of the Russian Empire. Service was maintained up to 1917, by which time £1,281,800 was outstanding. After Latvia was declared an independent republic, repeated efforts were made by the British bondholders to induce the municipality to recognize its liability for this loan. Their efforts were unsuccessful until July 1934, when an agreement was concluded, shortly after the Anglo-Latvian commercial treaty was signed, on the following basis. Arrears of interest were to be cancelled, the ultimate date of redemption was postponed from 1954 to 1984, the principal amount of each bond was reduced by 40 per cent., and the interest by ½ per cent. These terms applied only to bondholders who, at the date of settlement, were not Latvian citizens, holders of Nansen passports, or persons without nationality. The Latvian Government at the same time undertook to provide adequate guarantees for the carrying out of the arrangements and to impose no restrictions upon the transfer of service. The total nominal value of bonds recognized under the agreement was £1,217,200, but, owing to the writing down of the capital amount, the total nominal liability assumed by the municipality was £730,320. The only other important obligation incurred abroad during these years arose out of a contract concluded in August 1936 between the Latvian Government and a Swedish firm for the building of a power station at Keggum, on the Daugava near Riga.[2]

Reduction of Indebtedness. Apart from this, the chief changes can be seen from the table opposite which gives the latest figures available.

[1] See above, p. 169.

[2] According to the *Ost Express* of February 25, 1938, the total cost of this undertaking is estimated at about 52 million lats, of which about 14-4 million have been provided in the form of a credit of 11 million Swedish krone by the Swedish contractors. Of the balance, 33-6 million lats was raised by an internal State loan in February 1938.

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TABLE 55. *Gross Foreign Indebtedness*

(In million Swiss francs)

At end of:	Estonia			Latvia		Lithuania	
	1930	1935	1936	1930	1935	1930	1934
1. Intergovernmental debt	114·0	67·5	67·8	85·1	52·7	36·2	22·6
2. Other Government and municipal debt . . .	51·7	23·3	26·9	31·1	29·5	37·7	28·0
3. Foreign long-term investments in banks, industry, &c.	45·8	23·3	22·1	104·8	82·9	33·6	43·6
4. Private short-term debt and other debt . . .	?	0·9	3·8	137·3	106·7	15·9	10·6
Total	(211·5)	115·0	120·6	358·3	273·8	123·4	104·8

The large reduction in intergovernmental debt is due to the depreciation of the dollar and sterling, which accounts also for much of the decrease in the other items, especially Government and municipal debt. The small decrease in Latvia's Government and municipal debt is due to the inclusion, in 1935, of the Riga debt already mentioned. It remains to be added that neither Estonia nor Latvia has had the full benefit of this decrease in their foreign indebtedness, owing to the depreciation of their respective currencies. Yet the amount of foreign debt is still relatively small, and so far as can be seen the service imposes no heavy burden on any of the three States.

4. THE BANKING SYSTEM, 1931–7

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The crisis of 1931 had a severe effect upon the entire banking system. The commercial banks, which depended largely upon the financing of foreign trade, were the most seriously affected, owing to the general decrease of exports and imports, and especially to the exchange restrictions, which generally had the effect of centralizing dealings in foreign currency in the Central Banks or their nominees, while, as was seen, a large number of foreign credits made available to commercial banks in these countries by their foreign correspondents was withdrawn during 1930 and 1931. Mortgage banks, also, suffered severely through the decline in agricultural prices, which made it difficult, if not impossible, for peasants to meet the service of loans contracted when prices were considerably higher; and, as already noted, measures had to be taken to relieve such debtors in Estonia and Latvia. Finally, the general reduction in economic activity was inevitably reflected in the co-operative system, though the effect of the depression was less evident in this case than elsewhere.

The general recovery of the economic situation in all three countries has naturally been followed by an improvement in the position of

433 to be the value of her exports of bacon, butter, timber, and flax which,
● [457] as has been seen, are taken largely by the United Kingdom. Whether, in order to protect that market, Lithuania will be forced to realign her currency is perhaps open to question, but the fact that this step was not necessary during the crisis of 1931–5 suggests that no change is needed in her monetary policy for the moment. What is certain, however, is that her economic system has been working on too narrow a margin to permit of a rapid accumulation of capital, either in domestic currency or in *devisen*. There are no funds available for capital renewals of the more substantial kinds, or for large schemes of development. Ultimately these will be inevitable if the standard of living is not to remain exceptionally low, even for Eastern Europe; and their realization, therefore, will depend on Lithuania's ability to obtain foreign capital. In this she should be assisted by the low level of her foreign debt.

433 In Estonia and Latvia the productive system has become considerably more complex than it was before the crisis. The change, as was seen, consists largely in the increased importance of agriculture to the home consumer and the growth of industrialization. There can be little doubt as to the benefit accruing from the former of these developments in the saving of exchange on the import of cereals and other products now grown at home. So far as the latter is concerned, the advantages are, perhaps, less obvious. It is true that the volume of industrial production in both countries is probably far lower than in 1914. But before the War the industries of Estonia and Latvia were working for an assured and almost unlimited market; they now work primarily for the domestic market alone. Moreover, the lack of essential raw materials needed by industry clearly sets certain definite limits to the pursuit of self-sufficiency in this fashion. At the best, then, the saving in exchange as the result of this policy consists only in the difference between the cost of the raw materials and that of the manufactured article, and meanwhile the cost of importing the necessary machinery, &c., has been heavy, as was seen in Estonia during 1936, and still more in
[439] 1937. Thus, however far this development is pushed, both Latvia and Estonia, it would seem, will continue to rely on their exports of timber[1] and agricultural produce. Since, as in Lithuania, their free foreign exchange is derived largely from their balance of trade with the United Kingdom, the prosperity of both countries will depend in the last resort on their ability to maintain their position in that market.

000 The result of this change in the productive system, therefore, may

[1] It should be noted, however, that the extensive felling of timber may create a serious problem for all three countries in the more distant future. See above, pp. 114–15.

The result of this change in the productive system, therefore, may 433
not be large in itself; but it has been accompanied by a development 471
which may assume considerable importance, namely the increase in the extent of control exercised by the State over the economic system, both in Estonia and in Latvia. As has been seen, the increase has been most remarkable in Latvia, where there has been a steady progress towards a form of State capitalism. The movement has been less noteworthy in Estonia, it is true, but the tendency plainly exists, and its importance should not be underestimated. Some attempt was made to indicate the potential dangers to the financial position of the State which may result from such a policy, but this is by no means its only disadvantage. For, like Lithuania, both Estonia and Latvia are unable to accumulate capital on a scale sufficient to enable them to finance large schemes of development themselves, and they will depend for this on their ability to borrow abroad. Their need to do so, moreover, will presumably be greater than that of Lithuania owing to the greater degree of their industrialization, even if their standard of living as a whole is somewhat higher. But the pursuit of a policy of State capitalism, and the arbitrary methods which it sometimes involves, does little to encourage prospective lenders.

In general, then, the economic prosperity of the Baltic States 439
depends largely on their export trade, and this, in turn, depends 457 ●
largely upon the United Kingdom. Provided, therefore, that they can maintain the commercial relations they have built up with that country since 1934, and that agricultural prices do not fall substantially below present levels, the stability of their present economic existence should be assured so long as the respective Governments can avoid the dangers of State capitalism. But this means little more, in the last resort, than that the current income of the economic system will roughly suffice to cover current outgoings, and that the standard of living will remain at or around its present level. If reserves are to be accumulated, whether to ensure against a future depression or to finance the development needed to raise the standard of living, foreign capital will be indispensable.